

Franchising - Canada

Dunkin' Brands: Quebec court finds franchisor has duty to support its brand

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Franchising communities in the province of Quebec and elsewhere were anxiously awaiting the outcome of the Quebec Court of Appeal's decision in the long-running *Dunkin' Brands* case.⁽¹⁾ The judgment was finally rendered on April 15 2015, and upheld the Quebec Superior Court's decision. Throughout this saga, the Quebec courts have made significant determinations with respect to the scope and extent of a franchisor's contractual obligations based on explicit contractual terms and implicit principles that are established by law.

Facts

The case involved a suit filed in 2003 by 21 franchisees collectively operating 32 Dunkin' Donuts fast-food coffee and donuts businesses after the brand's demise in Quebec. The claim centred on the franchisor's insufficient actions with respect to competitive forces in the market, even after franchisees had brought their concerns to the franchisor's attention and made specific efforts to suggest corrections.

A major competitor with a similar business model, Tim Hortons, succeeded in rapidly gaining market share at the expense of Dunkin' Donuts franchisees in Quebec between 1995 and 2005. In Autumn 2000 the franchisor proposed a remodelling plan to its franchisees, which would be required to make a significant investment in their restaurants, with a certain level of matching of funds by the franchisor but without any certainty as to the outcome for their businesses. The franchisor also sought general releases from the franchisees as part of this proposal.

Once the Dunkin' Donuts brand had been all but conquered by Tim Hortons in Quebec, the remaining franchisees sought the termination of their franchise agreements and leases as well as damages from the franchisor.

The franchisees' action succeeded before the trial court, which concluded that the franchisor had breached its explicit contractual obligations as well as obligations that are implicit in franchise agreements under Quebec law. The court interpreted a provision in the preamble of the franchise agreement as imposing on the franchisor the obligation to "protect and enhance the reputation of Dunkin' Donuts and the demand for the products of the Dunkin' Donuts system",⁽²⁾ which the franchisor failed to do. The court also found that the franchisor had failed to protect its brand in Quebec, in particular with respect to the fierce competition that it was facing from Tim Hortons. The court rejected any argument advanced by the franchisor that the franchisees were poor operators and annulled the releases signed by certain franchisees on the basis of their being abusive and proper consent having been vitiated or non-existent. The court awarded the franchisees C\$16.4 million for loss of profits, loss of investment and other damages.

Decision

The Quebec Court of Appeal upheld the trial court's decision and confirmed the franchisor's liability for failing to protect its brand. However, the damages awarded to the franchisees were reduced to approximately C\$11 million based on additional factors that may have resulted in decreased financial performance by franchisees in any event, as well as certain portions of the claims being precluded on the basis of the applicable statutes of limitations.

A key finding of the appeal court was that the express terms of the franchise agreement required the franchisor "to protect and enhance" its brand. This was considered to be a binding contractual obligation; however, it was not viewed as a guarantee with respect to the financial viability of the brand, the franchised business or the success of any measures implemented by the franchisor in order to promote the brand or the business.

In addition, the parties' respective obligations were analysed by the appeal court in light of the

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fundamental nature of the franchise relationship: the court considered that the franchisor had undertaken to support its franchisees and oversee the operation of franchised outlets over an extended period of time, and therefore its obligations to generally protect the brand and to take steps to protect the network were implied, including with respect to threats from competing businesses.

These essential themes were explored and reiterated throughout the decision. In particular, the appeal court found that the franchisor had emphasised the importance and the value of the Dunkin' Donuts brand to its franchisees in order to entice them to join its network.⁽³⁾ The franchise agreement itself also contained provisions suggesting that the value of the brand was enhanced by virtue of the elevated operational standards of the system and the uniformity of operations imposed throughout the system.⁽⁴⁾ As a result, the franchisees – individually and collectively – were entitled to rely on the franchisor's duty to ensure that the value of the brand would remain intact and that the network would not be jeopardised as a result of the franchisor's failing to take measures to that end. The franchisor's obligations were found to apply both with respect to factors outside the franchised network, such as competitive forces, as well as internal matters, such as taking steps to ensure compliance by all franchisees with their obligations under their respective franchise agreements.

The franchisor has applied for leave to appeal before the Supreme Court of Canada; a judgment with respect to whether leave will be granted is expected in late 2015 or early 2016.

Comment

Through the explicit provisions of the franchise agreement and implied terms applicable to franchise relationships, the Quebec Court of Appeal has confirmed a franchisor's duty to support its brand and to take active measures that are consistent with this duty throughout the term of its franchise agreements.

It is not a novel concept for the nature of the franchise relationship itself to be seen as part of the foundation for the franchisor's obligation to conduct itself in good faith and to exhibit loyalty in favour of its franchisees: the implied obligation for parties to a franchise contract to conduct themselves in good faith had been previously applied in the context of a franchisor competing directly against its franchisee.⁽⁵⁾ The duty has now been applied in order to establish that a franchisor must make a sincere effort to support its brand and its franchisees. In *Dunkin' Brands* the practical effect was that the franchisor was required to take reasonable measures to protect its network from competitive forces in the market as part of its general obligation to provide ongoing assistance and cooperation.

A perhaps more remarkable conclusion of the appeal court is that a franchisor's duty to protect its network imposes the obligation for franchisors to take reasonable measures to enforce compliance by all franchisees with their obligations under their franchise agreements, with a view to weeding out 'bad apples' which may affect the brand image and have an impact on the success of the rest of the franchised network. As described by the appeal court, the "franchisees were entitled to count on the Franchisor to see that the system would be supervised and that the weaker links in the chain of franchisees be corrected or excised".⁽⁶⁾ Moreover, the appeal court stated as follows:

"It is up to the Franchisor to police the network by taking reasonable measures to root out the free-riders. It is up to the Franchisor to enforce the authority it has given itself under the franchise agreement. The explicit contractual 'right' it has to insist that the franchisee respect the uniform standards of the system brings with it a correlative obligation of means, owed collectively and individually to the complying franchisees, to see that the franchisees adhere to those standards. This is part of its obligation to protect the brand – an obligation 'owed to the network' that, juridically, is a duty owed to each of the franchisees as part of the agreement, whether that duty is explicit or not."⁽⁷⁾

Further, noting how few express obligations were incumbent on the franchisor in the Dunkin' Donuts franchise agreement, the court implied certain obligations of the franchisor that flowed from the principles of cooperation, collaboration, ongoing interaction and assistance that are essential in a long-term contractual arrangement, all of which the court determined to be fundamental tenets of the franchise relationship.⁽⁸⁾ The court's understanding of these cornerstones of franchising further supported its conclusions with respect to the franchisor's duty to protect its network and to generally enhance its brand and related operations.

Practical implications

Various practical tips may be gleaned from this important case:

- In order to avoid interpretative ambiguity and to mitigate the risk that courts will read in more onerous obligations for a brand than were intended, franchisors should critically review their franchise agreements with a view to removing statements pertaining to the significant value and goodwill of their trademarks and business model, as well as any provisions that may be construed as commitments to enhance or engage in continued development of their brand.
- Considering the multitude of operational requirements that are often imposed on franchisees and are central to their contractual compliance, franchisors should be mindful that the Quebec Court of Appeal has determined that there is a corollary obligation for franchisors to enforce these obligations across their network. As a result, franchisors may consider including in their franchise agreements specific defaults and termination rights where franchisees fail to comply with imperative operating requirements or otherwise engage in behaviour that may imperil the reputation of the franchised network and franchisors should not shy away from exercising their

rights under such provisions.

- The Quebec Court of Appeal also appears to have left open the possibility that certain forms of implied obligations could be varied or excluded by the express terms of a franchise contract;⁽⁹⁾ in other words, it may be more difficult for judicial authorities to imply terms where they would be contrary to the express provisions of a contract. As such, franchisors may be in a position to include specific clauses in their franchise agreements with a view to circumscribing the extent of their duties as concerns franchisees and the franchised network generally.
- Franchisors are encouraged to act responsibly and reasonably and to take steps to protect their networks, including by adequately responding to competitive threats in the market in a timely manner and by offering practical solutions to franchisees that raise concerns about the viability of the franchised system or the future of the franchised business. There is no specific guidance on the types of action that would be considered adequate and there is no obligation for a franchisor to achieve success with the measures that it implements; however, if a franchisor is in a position to demonstrate that it genuinely took reasonable actions to assist its network in dealing with competitive forces, it is unlikely that its conduct will be met with severe scrutiny.

Given the fundamental principles at issue in this case, as well as recent shifts in the scope of protections recognised for franchisees in various jurisdictions worldwide, the decision could have far-reaching consequences as the conclusions of this case are interpreted and applied as precedent for future franchising disputes, certainly within Quebec, but perhaps outside Quebec in both civil law and common law jurisdictions.

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Endnotes

- (1) *Dunkin' Brands Canada Ltd v Bertico Inc* 2015 QCCA 624.
- (2) *Ibid* at paragraph 32.
- (3) *Ibid*, at paragraph 81.
- (4) *Ibid* (see also footnote 27).
- (5) This principle was formalised by the Quebec Court of Appeal in *Provigo Distribution Inc v Supermarché ARG Inc* (1997), [1998] RJQ 47 (CA).
- (6) *Supra* note 1, at paragraph 62.
- (7) *Supra* note 1, at paragraph 85.
- (8) *Supra* note 1, at paragraph 59, 62 and 63.
- (9) *Supra* note 1, at paragraph 65.

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